

Sewer Service and Use Charge Fund

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T*o account for the financing, construction, and operation of the sanitary sewer system and for San José's share of the financing, construction, and operation of the regional San José/Santa Clara Water Pollution Control Plant (WPCP). Services provided through this fund are:*

- *Sewer maintenance;*
- *Sewer rehabilitation; and*
- *Sewage treatment at the Water Pollution Control Plant*

Sewer Service and Use Charge Fund

Budget Summary

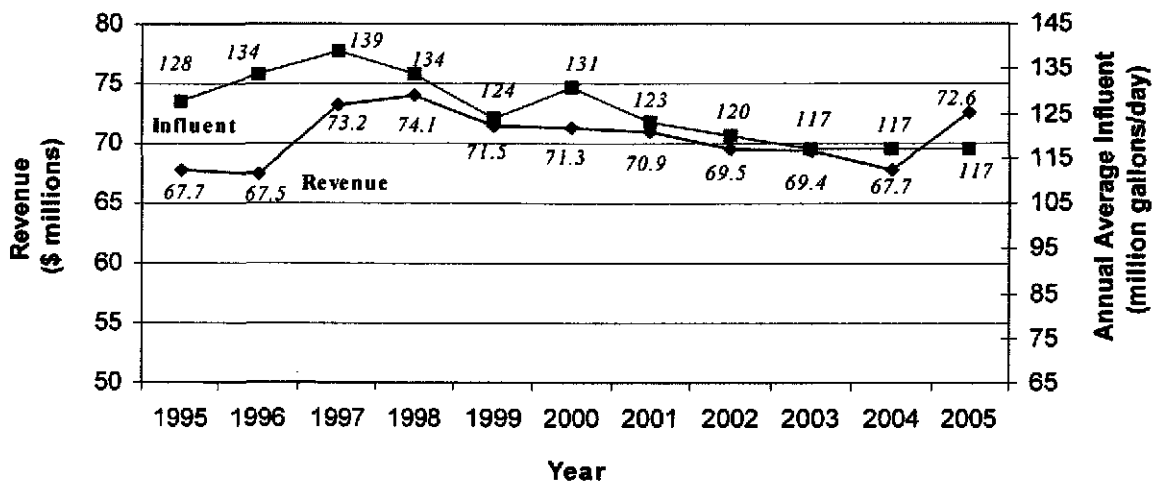
	2005-2006 Adopted	2006-2007 Adopted	Change
Sewer System Maintenance and Admin.	\$ 17,759,993	\$ 20,865,772	17.5%
Sanitary Sewer Rehabilitation	\$ 14,475,000	\$ 15,375,000	6.2%
Water Pollution Control Plant	\$ 46,482,236	\$ 49,636,000	6.8%

Budget Highlights 2006-2007

- The third year of a three year 4.5% Council-approved rate increase strategy to the Sewer Service and Use Charge fees was approved to adequately fund maintenance and rehabilitation of the sanitary sewer system, Water Pollution Control Plant, and the South Bay Water Recycling program.
- A total of 11 additional positions were approved to address pre-treatment monitoring and enforcement (8.0), increased engineering services at the Plant (2.0), and operations support for the conversion of the Plant's maintenance management software system (1.0).

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Sewer Service and Use Charge Fund Historical Trend of Revenues in Relation to Influent Flows (millions of gallons per day compared to revenue in millions)



Sewer Service and Use Charge Fund

Fund Overview

This fund serves as the primary revenue source for several other funds which include the San José/Santa Clara Treatment Plant Operating and Capital Funds, and the Sewer Service and Use Charge Capital Improvement Fund, through annual transfers. In cooperation with the Departments of Environmental Services, Public Works, and Transportation, these funds are managed to deliver services in the most efficient and cost-effective manner.

Included in the fund balance is a Rate Stabilization Reserve of \$2 million, which was established in response to covenants in the bonds issued in 1995 to finance the construction of the South Bay Water Recycling project. The annual debt service cost for that project is \$5.5 million after the refinancing of the bond in 2005-2006.

The primary source of this fund's revenues are the fees paid through tax-based assessments within the residential, commercial, and industrial sectors. Prior to 2004-2005, these fees had remained at the same rate for ten years. For the past several years, the Sewer Service and Use Charge Fund had experienced flat or declining revenues in relation to two primary factors. First, the downturn in the economy slowed revenue growth as residential development decreased, rendering the growth rate to below 0.5%. Second, and more significantly, industrial and commercial migration from the area has substantially reduced revenues from these sectors.

Specifically, 3.5% of the decreased revenues is the result of six large industrial users that ceased operations in San José between 2000 and 2004, representing a loss of \$2.5 million in annual revenues. The combined impact of the economic downturn and commercial and industrial migration over the past several years

has reduced revenues by a level equivalent to 9% from the high point in 1998-1999.

In the 2004-2005 Adopted Operating Budget, the City Council gave conceptual approval to a three-year rate increase strategy of 4.5% annually. The approved increase in 2006-2007 represents the third year of this strategy. This third increase will increase rates by \$0.94 per month, from \$20.70 to approximately \$21.64 per month for single-family residence owners.

Even with this rate increase, as a result of the trends discussed above, current year projections indicate that expenditures will exceed revenues, resulting in a deficit spending of approximately \$4.4 million. Without the approved 4.5% rate increase for 2006-2007, the projected revenue shortfall would have otherwise produced approximately \$8.6 million in deficit spending for that year. Some short-term relief has been provided through the determination that it was possible to transfer approximately \$12.5 million back to this fund from a debt service fund (the Clear Water Financing Authority Payment Fund) as a result of past overpayments of Sewer Service and Use Charge fund for debt service. In the longer term, however, it is imperative that the deficit spending pattern be resolved through appropriate rate increases.

Although the majority of the operating expenditures associated with this fund have followed a stable and predictable rate of inflation, there have been several items that have exceeded expenditure projections during this period. Most notable among these has been the increase in energy costs over the past four years. Natural gas and electricity costs at the treatment plant have risen significantly despite numerous energy efficiency programs that have reduced the energy demand per million gallons treated.

Sewer Service and Use Charge Fund

Fund Overview (Cont'd.)

Although natural gas prices have stabilized at least momentarily, they remain volatile and significantly above 1999-2000 levels. Other items that have exceeded the general rate of inflation include vehicle and facility maintenance costs, workers' compensation costs, retirement, and other personnel related costs.

As operating expenses are increasing, the Treatment Plant's capital infrastructure needs are becoming ever more critical. Over 50% of the Plant's infrastructure exceeds thirty years of age, reflecting the expansion to an advanced wastewater treatment facility in the early to mid 1970's. Several major components of the Treatment Plant are reaching the end of their useful years of service, thereby creating the need for several critical infrastructure upgrades and rehabilitation projects which are described in the 2007-2011 Adopted Capital Improvement Program.

In addition to the impending rehabilitation projects over the next ten years, it will be necessary to fund a number of planned security projects at the Plant. The most critical project with the greatest budgetary impact is the conversion from gaseous chlorine as the primary disinfection source to alternate methods in order to address security concerns. The completion of the project, estimated for 2006-2007, is projected to increase chemical costs by \$3.5 million, or approximately 5% of current year revenues.

In order to maintain the Fund's long-term financial health, and fund both operations and maintenance requirements and critical capital projects the implementation of the third year rate increase of 4.5% for 2006-2007 was approved. Moreover, with respect to current revenue and expenditure trends and capital infrastructure needs, it is clear that additional and regular rate increases in the coming years will be necessary.

Fund Summary

	2004-2005 Actual 1	2005-2006 Adopted 2	2006-2007 Adopted 3	% Change (2 to 3)
Dollars by Sources				
Beginning Fund Balance	\$ 18,261,360	\$ 16,559,133	\$ 29,735,178	79.6%
Sewer Service and Use Charges	72,253,475	74,836,144	78,923,155	5.5%
Interest and Other	421,259	319,647	499,177	56.2%
Transfers	52,000	23,000	1,416,000	6056.5%
Total	\$ 90,988,094	\$ 91,737,924	\$ 110,573,510	20.5%
Dollars by Uses				
Sewer System Maintenance and Admin.	\$ 15,670,010	\$ 17,759,993	\$ 20,865,772	17.5%
Sanitary Sewer Rehabilitation	12,475,000	14,475,000	15,375,000	6.2%
Water Pollution Control Plant	44,754,736	46,482,236	49,636,000	6.8%
Ending Fund Balance	18,088,348	13,020,695	24,696,738	89.7%
Total	\$ 90,988,094	\$ 91,737,924	\$ 110,573,510	20.5%

Sewer Service and Use Charge Fund

Budget Category: Sewer System Maintenance and Administrative Services

Budget Category Overview

This category is responsible for Sewer System Maintenance and Administrative Services. System Maintenance is performed by the Department of Transportation, the Department of Public Works, and the General Services Department to repair damaged sewer pipes and maintain

the system infrastructure. Information Technology Department service costs are also included in this category. Administrative Services include support services provided by various City departments, overhead to the General Fund, fees charged by the County for collecting assessments, and audit costs.

Budget Category Summary

Sewer System Maintenance and Administrative Services	2004-2005 Actual 1	2005-2006 Adopted 2	2006-2007 Adopted 3	% Change (2 to 3)
Sewer System Maintenance	\$ 9,758,063	\$ 11,793,629	\$ 12,784,494	8.4%
Administrative Services	5,911,947	5,966,364	8,081,278	35.4%
Total	\$ 15,670,010	\$ 17,759,993	\$ 20,865,772	17.5%

The following changes were approved in 2006-2007 in the Sewer System Maintenance and Administrative Services allocations:

Adopted Allocation	2005-2006 Adopted	Change	2006-2007 Adopted
Sewer System Maintenance	\$ 11,793,629	\$ 990,863	\$12,784,492

Increases to the Sewer System Maintenance Program for the 2006-2007 Adopted Operating Budget reflect salary and benefit cost increases in the Departments of Transportation, Public Works, General Services, and Information Technology (\$780,461), and non-personal/equipment adjustments in the Information Technology Department (\$124,746), Department of Transportation (\$93,500), and Public Works Department (\$5,000). These increases were partially offset by reductions in lease costs (\$12,840) in the General Services Department.

Sewer Service and Use Charge Fund

Budget Category: Sewer System Maintenance and Administrative Services

Budget Category Summary (Cont'd.)

Adopted Allocation (Cont'd.)	2005-2006 Adopted	Change	2006-2007 Adopted
Administrative Services	\$ 5,966,364	\$ 2,114,914	\$ 8,081,278
<p>Changes in the Administrative Services Program for the 2006-2007 Adopted Operating Budget were due in part to the increase in overhead charges (\$755,401), City Hall costs (\$269,450), and the first installment of the Commercial Paper reimbursement for the Consolidated Utility Billing System project (\$418,992). The establishment of a Fats, Oils and Grease Inspection Program will increase Environmental Services Department personal services (\$296,496) and non-personal/equipment costs (\$125,000). Additional overstrength staff for the Consolidated Utility Billing System will increase Environmental Services personal services (\$24,943) and Finance personal services (\$45,373). Other adjustments include: personal services adjustments in the Finance Department (\$64,878), Environmental Services Department (\$37,458), City Attorney's Office (\$30,426), Planning, Building and Code Enforcement Department (\$14,622), and City Manager's Office (\$1,923); increased workers' compensation claims (\$16,260), and increased collection costs (\$14,047).</p>			
Total Sewer System Maintenance and Administrative Services	\$ 17,759,993	\$ 3,105,779	\$20,865,772

Sewer Service and Use Charge Fund

Budget Category: Sanitary Sewer Rehabilitation

Budget Category Overview

The Sanitary Sewer System Rehabilitation category consists of capital projects designed to rehabilitate the sanitary sewer system, with higher priorities given to those with extensive, severe

deterioration. Rehabilitation projects of existing sewers are selected on the basis of pipe corrosion studies, maintenance reports, infiltration analysis, and actual pipe failures.

Budget Category Summary

	2004-2005 Actual 1	2005-2006 Adopted 2	2006-2007 Adopted 3	% Change (2 to 3)
Sanitary Sewer Rehabilitation				
Transfer to Capital Fund	\$ 12,475,000	\$ 14,475,000	\$ 15,375,000	6.2%
Total	\$ 12,475,000	\$ 14,475,000	\$ 15,375,000	6.2%

The following changes were approved in 2006-2007 in the Transfer to Capital Fund allocation.

Adopted Allocation	2005-2006 Adopted	Change	2006-2007 Adopted
Transfer to Capital Fund	\$ 14,475,000	\$ 900,000	\$15,375,000

The Sanitary Sewer System Rehabilitation program was for a number of years funded by an annual transfer of \$16 million to the Sewer Service and Use Charge Capital Improvement Fund from the Sewer Service and Use Charge Fund to support the costs of rehabilitation of existing sewers. A decrease of \$1.525 million was approved as part of the 2004-2005 Adopted Operating Budget in response to ongoing deficit spending in the Sewer Service and Use Charge Fund described earlier and continued at that level in 2005-2006. This transfer supports major projects including those related to the rehabilitation of the Major Interceptor System, neighborhood sewers, and the Inflow and Infiltration (I&I) Reduction projects. The rehabilitation projects will prevent and/or correct pipe failures such as collapses, flow stoppage, and the spilling of sewage. For 2006-2007, a \$900,000 increase to the level of transfer was approved to provide funding for Interceptor Cleaning (\$600,000) and Hydrogen Peroxide Injection Station (\$300,000). The specific elements of this program are described in the 2007-2011 Adopted Capital Improvement Program.

Total Sanitary Sewer Rehabilitation	\$ 14,475,000	\$ 900,000	\$15,375,000
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Sewer Service and Use Charge Fund

Budget Category: Water Pollution Control Plant

Budget Category Overview

This category provides for operational costs, support services, and debt service requirements for the San José/Santa Clara Water Pollution Control Plant (WPCP). This regional wastewater treatment facility serves eight tributary sewage collection agencies, including municipalities and sanitary

sewer districts. The WPCP processes wastewater, operates a Bio-solids Reuse Program, and administers the South Bay Water Recycling Project. In addition, it plans, designs, and constructs new wastewater treatment facilities and provides system maintenance.

Budget Category Summary

	2004-2005 Actual 1	2005-2006 Adopted 2	2006-2007 Adopted 3	% Change (2 to 3)
Water Pollution Control Plant				
Treatment Plant Operating Fund	\$ 32,000,000	\$ 36,500,000	\$ 39,500,000	8.2%
Treatment Plant Capital Fund	5,456,000	3,072,000	4,672,000	52.1%
SBWR Revenue Bonds ('95)	7,298,736	6,910,236	5,464,000	(20.9%)
Total	\$ 44,754,736	\$ 46,482,236	\$ 49,636,000	6.8%

Transfers to the above wastewater-related funds support the operating, capital, and debt service costs of the Water Pollution Control Plant.

One of the primary sources of expenditures in the past several years has been diversion activities associated with the 120 million gallons per day (mgd) flow trigger to the South San Francisco Bay. The diversion of fresh water effluent from the Bay prevents saltwater marsh conversion. This diversion of fresh water has been primarily achieved through the Revised South Bay Action Plan (Plan), as approved by City Council in June 1997.

The projects within this Plan include expanded water recycling, industrial water recycling/reuse, inflow/infiltration reduction, and environmental enhancement pilots. Recycled water is used by industrial and institutional users, diverting water that would otherwise be discharged to the Bay. For 2006-2007,

approximately 13.5 mgd of recycled water is projected to be diverted, due primarily to the delivery of recycled water. This represents a 1.0 mgd increase compared to the 2005-2006 year-end estimate.

For the 2005 reporting period the dry-weather effluent averaged 100 mgd, well below the 120 mgd flow trigger. This is an increase, however, of 2.5 mgd over the 2004 period and marks the first time in several years that current year levels exceeded the prior year. This is likely due to the modest economic recovery within the area over the past several months as dry-weather influent has also increased after years of a downward trend.

Sewer Service and Use Charge Fund

Budget Category: Water Pollution Control Plant

Budget Category Summary (Cont'd.)

The following changes were approved in 2006-2007 in the support of this fund to the Treatment Plant Operating Fund, Treatment Plant Capital Fund, and SBWR Revenue Bonds ('95) allocations:

Adopted Allocation	2005-2006 Adopted	Change	2006-2007 Adopted
Treatment Plant Operating Fund	\$ 36,500,000	\$ 3,000,000	\$ 39,500,000
For 2006-2007, an increase of \$3 million to the transfer from the Sewer Service and Use Charge Fund to the Treatment Plant Operating Fund was approved to provide sufficient funds for program expenses related to the Water Pollution Control Plant. Transfer amounts from this fund to the Treatment Plant Operating Fund vary each year based on the anticipated ending fund balance in that fund.			
Treatment Plant Capital Fund	3,072,000	1,600,000	4,672,000
The reprioritization of funds and resources required to fund the construction award of the Plant Reliability Improvements project in 2004-2005 has forced some previously scheduled projects to be rescheduled into future years. The remaining funds represent funding for only the most critical capital needs at the Plant for 2006-2007.			
SBWR Revenue Bonds ('95)	6,910,236	(1,446,236)	5,464,000
To take advantage of favorable interest rates, the 1995 Bond Series A & B were refinanced in 2005-2006 generating approximately \$10,000,000 of savings over the life of the bonds.			
Total Water Pollution Control Plant	\$ 46,482,236	\$ 3,153,764	\$ 49,636,000